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National City Company,
New York

“Burlington joints”

New York

1921

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"Burlington Joints"



An intimate study of three great
Railroads in the Northwest

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The National City Company

"Burlington Joints"

A STUDY of the financing,
business and property of the
CHICAGO, BURLINGTON & QUINCY
GREAT NORTHERN *and* NORTHERN
PACIFIC RAILROAD SYSTEMS

3

NEW YORK

1921





"Burlington Joins"

Acquisition of the Chicago, Burlington & Quincy Railroad Co.

IN the latter part of the year 1900, the Great Northern and Northern Pacific Railway Companies quietly began negotiations for the acquisition of the Chicago, Burlington & Quincy Railroad Co. It was not until April 1901, however, that a formal proposition was received by Mr. Francis W. Hunnewell, Chairman of the Board of the Burlington, offering to purchase the stock of that road at the rate of \$200 per share in bonds which were to be the joint and several obligation of the Northern Pacific and Great Northern Railway Companies.

During the last week in March 1901, influenced by the rumor of these negotiations, the stock of the Burlington, which was selling around 163, began to advance sharply. When the formal offer was made the price had reached 199, and the Joint 4s were quoted on the curb, when issued, at 100 $\frac{3}{8}$ - $\frac{5}{8}$.



Stock Received 6% Dividends

Burlington stock at that time was receiving 6% dividends, and as the offer was therefore equivalent to an 8% return, the proposition was so attractive that on May 25th of that year the announcement was made that holders of over 90% of the stock had agreed to accept exchange for the Joint bonds. Subsequently the two north-western lines acquired additional stock until at present they hold 97.13% of the entire outstanding stock of the Burlington, which stock forms the collateral security for \$215,227,000 of Joint bonds.

The Maturity of the Joint 4s

The Joint 4% bonds issued in the above manner twenty years ago, fall due July 1, 1921. This maturity, we believe, is the largest corporate maturity in the history of American finance, and the present pamphlet has been prepared to tell something of the three railroads concerned, as well as give a brief description of the exceptional security of the new bonds which are being sold to provide funds to meet this maturity.



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[4]



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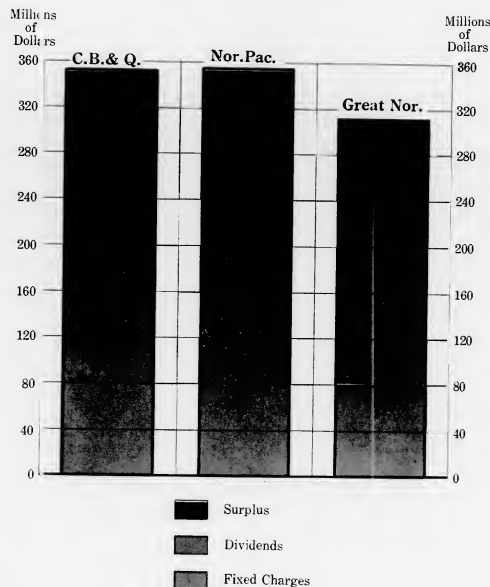
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[5]

Aggregate Results of Operation

1910 to 1919 inclusive



[6]

Why the Great Northern and Northern Pacific Wanted the Burlington

THE principal eastern termini of the Great Northern and Northern Pacific are at St. Paul, Minneapolis and Duluth, from which points the lines extend westward to the Pacific Coast. The need of an artery of traffic of their own from the Twin Cities to Chicago was manifest. Furthermore, the desire to secure more of the great volume of business originating in the Burlington territory was compelling.

Speaking of this acquisition, Mr. James J. Hill, in 1912, said: "Time has confirmed the wisdom of this act by which through traffic shipments have been simplified and the public has gained much by the drawing together of markets and the quick and cheap distribution of products between Chicago, St. Louis and the Pacific Coast."

The Growth of the Chicago, Burlington & Quincy

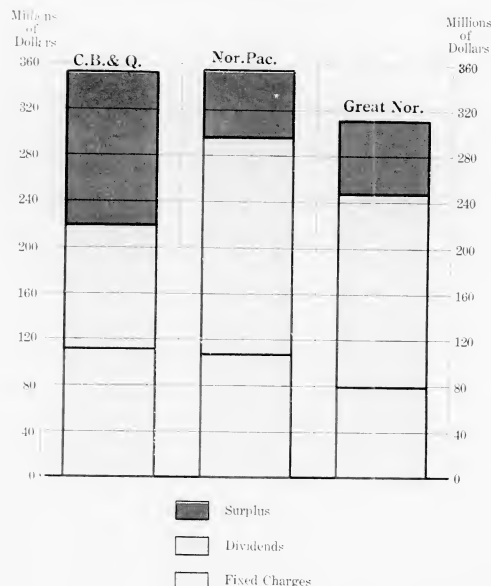
This railroad, which is one of the greatest of American railroads, has maintained an uninterrupted corporate existence since February 14, 1855, when it possessed a main line of only 76 miles. In 1901, when its control was acquired, it owned over 7,600 miles of road, was doing an annual gross business of over \$50,000,000, and had a capitalization of \$257,782,000, of which \$147,204,300 was funded debt and \$110,577,700 was capital stock. It paid dividends without interruption since 1861, and the rate in the three years prior to its purchase by the Great Northern and Northern Pacific was 6%. After the control passed the dividend rate was increased to 7% per annum. This rate obtained until the end of 1907. During this time, therefore, the ownership of the Burlington was a burden to the owning roads to the extent of 1% per annum on the Joint bonds. A reserve, however, had been set up for the purpose of reimbursing the owner companies and in October, 1907, the dividend was increased to 8% per annum and an extra dividend of 6% was declared which liquidated the deficiency. Since that date the regular dividend distribution has been at the rate of 8% per annum, but one extra dividend amounting to 10% was paid September 25, 1917.

On February 28, 1921, when the Interstate Commerce Commission gave the Burlington permission to declare a stock dividend of \$40,000,000, thus bringing the amount of its stock up to \$170,839,100, it stated, among other things: "The evidence establishes (1) That the Chicago, Burlington & Quincy Railroad has a great uncapped surplus; (2) That the present capitalization is far below the actual investment, or any fair value for rate making purposes which we may subsequently fix under the Valuation Act; (3) That the increase in capitalization which would follow the grant of this authority, would

[7]

Aggregate Results of Operation

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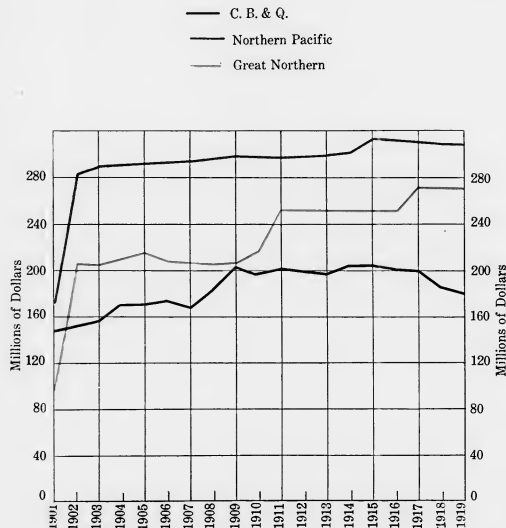
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The Growth of the Chicago, Burlington & Quincy

This railroad, which is one of the greatest of American railroads, has maintained an uninterrupted corporate existence since February 14, 1855, when it possessed a main line of only 70 miles. In 1901, when its control was acquired, it owned over 7,000 miles of road, was doing an annual gross business of over \$50,000,000, and had a capitalization of \$257,782,000, of which \$147,204,300 was funded debt and \$110,577,700 was capital stock. It paid dividends without interruption since 1861, and the rate in the three years prior to its purchase by the Great Northern and Northern Pacific was 6%. After the control passed the dividend rate was increased to 7% per annum. This rate obtained until the end of 1907. During this time, therefore, the ownership of the Burlington was a burden to the owning roads to the extent of 1% per annum on the joint bonds. A reserve, however, had been set up for the purpose of reimbursing the owner companies and in October, 1907, the dividend was increased to 8% per annum and an extra dividend of 6% was declared which liquidated the deficiency. Since that date the regular dividend distribution has been at the rate of 8% per annum, but one extra dividend amounting to 10% was paid September 25, 1917.

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Funded Debt Outstanding 1901 to 1919 inclusive



still leave the total capitalization of the Burlington below the actual investment, and the probable fair value of the property devoted to the public service; (4) That the remaining uncanceled surplus would be sufficient to serve the purposes for which a surplus should be accumulated."

During the twenty years the old Joint 4s have been outstanding, the Burlington has had aggregate earnings of \$324,189,000 available for dividends, out of which dividends amounting to **\$186,002,758** have actually been paid; that is, the earnings have been equivalent to 15.39% per annum and the dividends have averaged 8.11%. The dividend policy has therefore been extremely conservative, and the property has been built up to an extraordinary extent out of earnings. This fact is set forth distinctly in the accompanying table:

	1919	1901	Increase
Total Property Investment,			
less Depreciation.....	\$496,645,054	\$297,493,857	\$199,151,197 — 66.94%
Total Capitalization.....	278,889,100	257,782,000	21,107,100 — 8.19%

This record, we believe, is without parallel among American railroads. The surplus shown on the balance sheet has grown from \$57,975,892 in 1901, to \$241,781,197 in 1919.

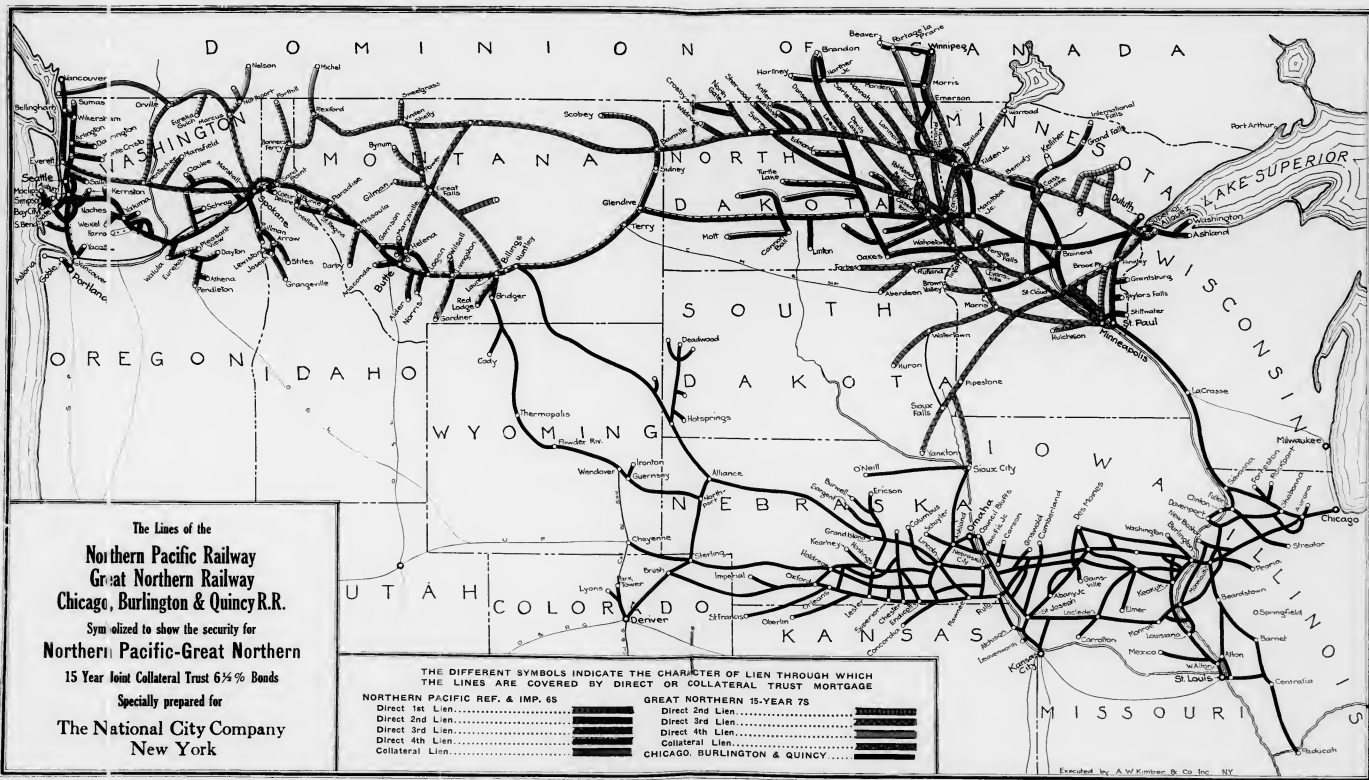
The funded debt is only \$18,634 per mile of road owned, the lowest figure reported by any of the major carriers. It was \$19,333 per mile in 1901.

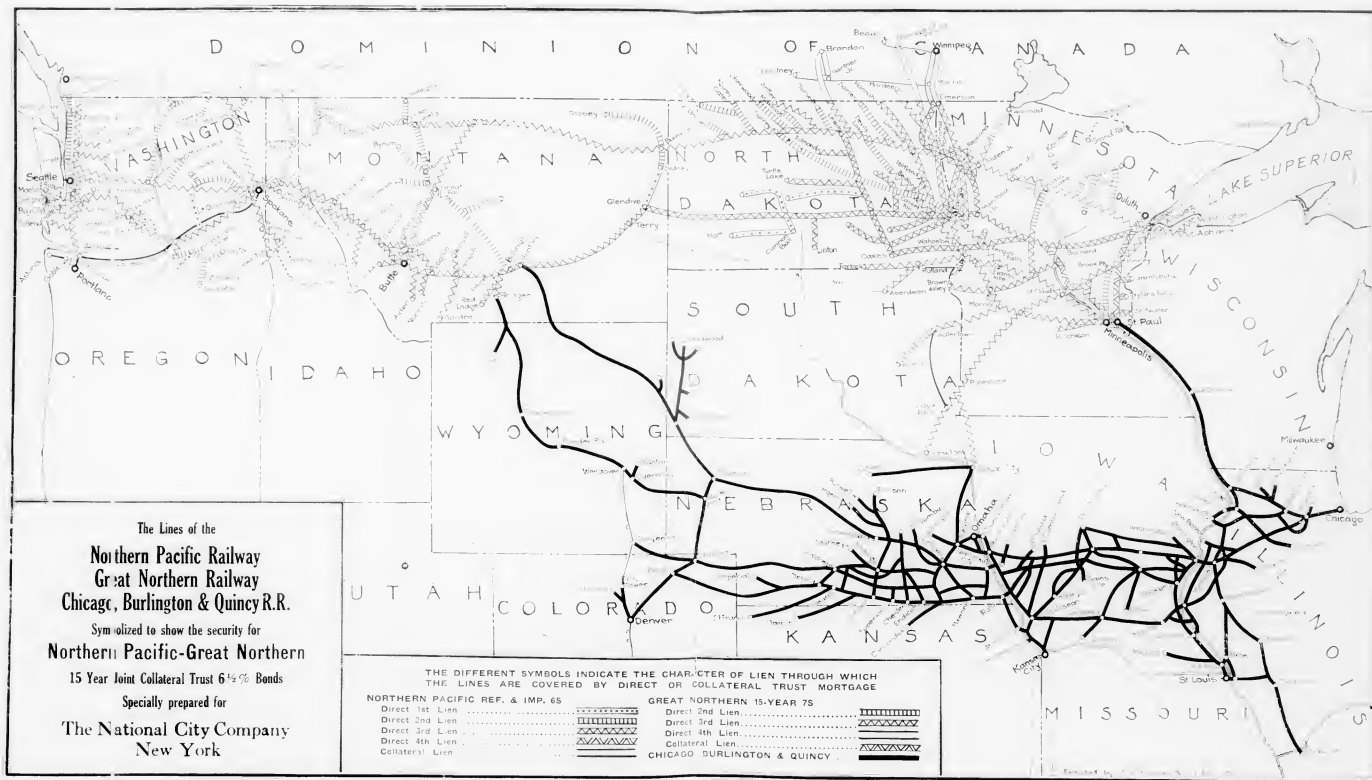
The Burlington owns 8,948 miles of road and operates 9,372 miles. Its lines extend northwesterly from Chicago to the Twin Cities, southwestly to St. Louis and Kansas City, and stretch as far west as Denver and Billings, Montana. It owns extensive and valuable terminals in some of the most important traffic centers of the country and expensive bridges over the Mississippi, Missouri and Platte Rivers. Its lines lie in twelve states. Through its control, by stock ownership, of the Colorado & Southern, it reaches the Gulf of Mexico at Galveston.

The Obligors

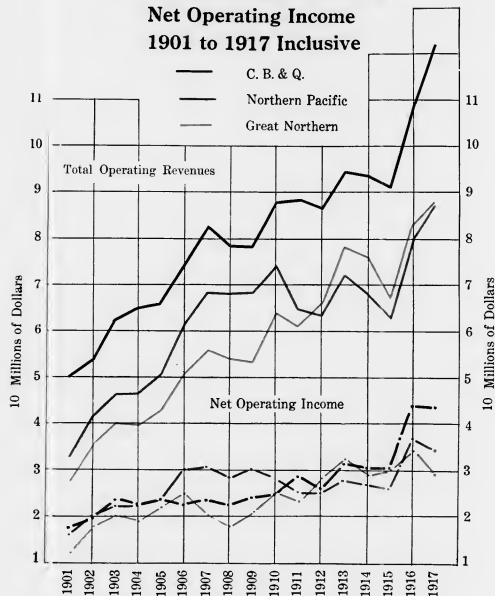
Among bond men the legal title of the "Northern Pacific-Great Northern Four Percent Joint Bond, Chicago, Burlington & Quincy Collateral"—has been abbreviated to the term "Burlington Joint's", and many people may have assumed that the Chicago, Burlington & Quincy Railroad Co. was in some way responsible for these bonds. This is of course not true. The bonds are collaterally secured by the equity in the Burlington, but the obligors are the Northern Pacific and the Great Northern Railway Companies, which are each liable for the full amount of the bonds.

From the brief analysis given of the financial strength of the Chicago, Burlington & Quincy, it is clear that the old Joint 4s and the new Joint 6½s





**Comparison
of
Total Operating Revenues &
Net Operating Income
1901 to 1917 Inclusive**



have unusual security in that they are secured not only by the promise to pay of two of the strongest railroads of the country, but are collaterally secured by stock which had a book value of \$318 a share in 1919, and even after the increase in capital as a result of the recent stock dividend, is \$206 a share. A discussion of the history, growth and financial strength of the two obligor railway companies is now in order.

The Northern Pacific

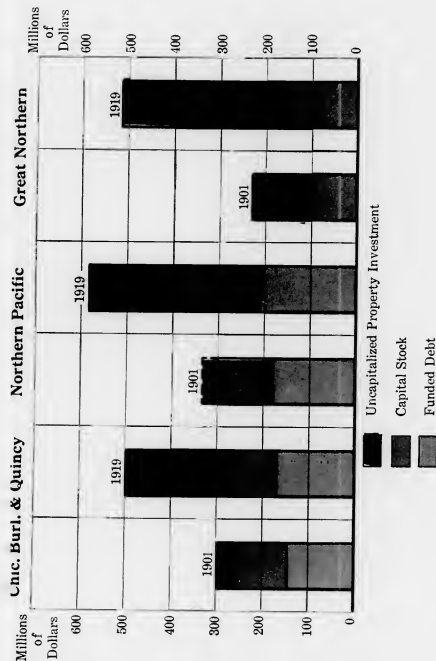
The project of the Northern Pacific Railway was the result of the foresight of a number of Boston capitalists who visualized the possibilities of the northwestern territory and the ultimate need of a second line from the middle west to the Pacific Coast for the two-fold purpose of development of the northwestern territory and to open a new artery of traffic for Asiatic trade. The first meeting of the Board of Commissioners of the Northern Pacific was held in Melodeon Hall, in the City of Boston, on the first day of September 1864, which was the year the original charter of the property was granted. Construction was not begun, however, until July 1870, and the entire main line from Ashland, Wisconsin, to Portland, Oregon, was opened for business in September 1883.

As in the case of many of the American railways, the Northern Pacific was built ahead of its time and so much money had been put into the construction of the property that there were no funds available to tide it through the lean period which has always followed the projection of an extensive trunk line through an undeveloped territory. As a result, ten years after the opening, receivers were appointed for the company, and in 1896, the property was reorganized and turned over to the present company.

The Northern Pacific is sometimes referred to as a granger line, but so well diversified is its list of commodities transported that the entire products of agriculture amount to only approximately 20% of the total. Not only does the Northern Pacific serve the rich agricultural section of the northwest, but it also taps the large ore producing mines and timber belts of that section. West of the Rocky Mountains during the past twenty years numerous manufacturing enterprises have been established, the products of which are sold principally in the eastern markets. This business has grown so extensive that the products of manufactures now make up approximately 12% of the total tonnage.

The Northern Pacific today extends from St. Paul, Minneapolis and Duluth in the east, to Portland and to Tacoma and Seattle on the Pacific Coast, and has to a total mileage of 7,052 miles.

Comparison of Capitalization and Property Investment



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The changes that have taken place in the capitalization and property accounts of the Northern Pacific since it joined in the purchase of the Burlington are here set forth:

	1919	1901	Increase
Total Property Investment, less Depreciation.....	\$682,139,036	\$314,836,176	\$367,302,860 — 116.3%
Capital Stock	248,000,000	155,000,000	93,000,000 — 60.0%
Funded Debt	202,108,000	177,925,789	24,182,211 — 13.6%
Total Capitalization....	\$450,108,000	\$332,925,789	\$117,182,211 — 35.2%

* Does not include Northern Pacific's share of C. B. & Q. Joint 4% bonds.

Reduced to a per mile basis, it appears that there has been an increase of \$41,301, or 70%, in the Property Investment (from \$58,705 per mile in 1901 to \$100,006 in 1919), while the total capitalization has increased only \$3,909 per mile, or 6.3%. Even more striking is the fact that the funded debt has decreased from \$33,177 to \$29,630 per mile, the capital stock having increased from \$28,902 to \$36,358 per mile.

The capital stock was increased in 1906 by the sale to stockholders of \$93,000,000, at par for cash. In the corner of 1901, Northern Pacific stock sold at \$1,000 a share. Its high price in normal markets has been \$232½ and its average price since 1901 has been \$140. The dividend rate has been 7% for the past eighteen years.

The earning power of the system is demonstrated by the following figures which are the aggregate results for the years, 1901-1919 inclusive.

Earnings available to meet fixed charges.....	\$559,492,000
Fixed Charges	166,013,000
Fixed charges have been earned, therefore, 3.37 times.	
Similarly, the amount available for Dividends was.....	\$393,479,000
Dividends paid	275,410,000

The earnings have averaged 10% on the stock and the payments made to stockholders have averaged 7.33%.

The bonds of the Northern Pacific have had a very high standing among investors, proved by the fact that its Prior Lien 4s and General Lien 3s, since 1900, have never sold as low as a 6% basis—even in times of panic.

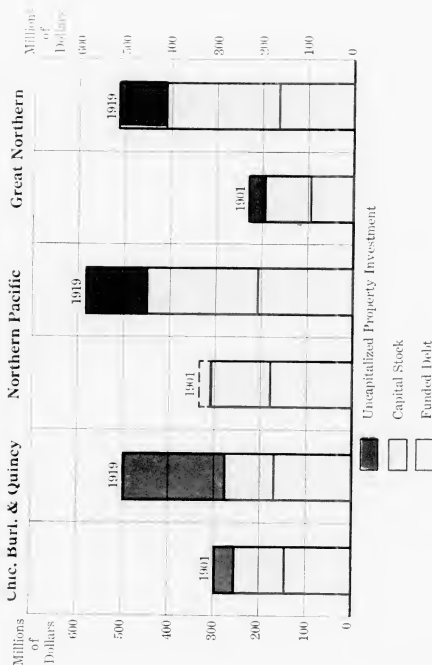
Great Northern

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The present Great Northern Railway System is a monument to the

courage, foresight and ability of four men who, in 1878, purchased from disheartened Dutch bondholders a discredited railroad of about 300 miles called the St. Paul & Pacific. The four men were George Stephen, later Lord Mount Stephen, Donald A. Smith, afterwards Lord Strathcona, Norman W. Kittson and James J. Hill. From very meagre beginnings they built up one of the great railroad systems of the country, first known as the St. Paul, Minneapolis & Manitoba, and later as the Great Northern Railway Company. The original 300 miles of road have expanded to more than 7,800 miles.

No one knew the story of the Great Northern better than Mr. Hill. The following, taken from his own account of the property, carries the weight of authority:

"All the other transcontinental lines had received large subsidies in cash or land grants, or both. They suffered the check of financial stresses and passed through receivership and reorganization. The Great Northern, which includes the Manitoba, never failed, never passed a dividend, never was financially insecure in any time of panic. For thirty-three years its credit has been unimpaired and its resources equal to any demands upon them. . . . The financial outlook of this company is as well assured as that of most Governments. It has a provision made now deliberately and not under any pressure of necessity, for the work of years to come. This provision may be utilized in lean years and held in suspense in fat years, so as always to realize the best prices for securities and to keep the credit of the company unimpaired. . . . There has never been a dollar's worth of stock or bonds issued that was not paid for in cash, property or services, at its actual cash value at the time. . . . The Great Northern is now wrought so firmly into the economic as well as the corporate body of the land as to have fitted itself permanently into the natural frame of things. So far as any creation of human effort can be made it will be proof against the attacks of time."

Like the Northern Pacific, the Great Northern's figures reflect the soundest financial policies. Its property stands on its books today at about \$400,000,000 more than in 1901. Nearly half of the expansion has been cared for out of surplus, and more than a third by the sale of stock. The actual figures follow:

	1919	1901	Increase
Total Property Investment, less Depreciation.....	\$625,599,813	\$228,164,066	\$397,435,747 — 174.2%
Capital Stock	249,478,250	98,711,750	150,766,500 — 152.8%
Funded Debt	162,910,515	96,683,455	66,227,060 — 68.5%
Total Capitalization ..	\$412,388,765	\$195,395,205	\$216,993,560 — 111.0%

*Does not include Great Northern's share of C., B. & Q. Joint 4% Bonds.

The investment has increased from \$41,880 per mile of road to \$87,717.

while the funded debt, exclusive of the Joint bonds, increased only \$5,144 per mile—from \$17,746 to \$22,890.

Since 1901, Great Northern preferred stock (there is no issue of common stock) has sold as high as \$348 a share. Like the Northern Pacific, the Great Northern has utilized every favoring opportunity for the financing of its growth by the sale of stock. Since 1901, \$150,766,500 of new stock has been sold for cash or issued in the acquisition of new property.

During the twenty-year period we have been reviewing, the Great Northern has earned to meet its fixed charges a total of.....	\$475,489,645
Its fixed charges aggregated.....	114,068,115
Fixed charges have therefore been earned 4.16 times.	
The amount available for dividends was.....	\$361,421,530
Dividends paid	248,512,115

The earnings have averaged 10½% on the stock, while the dividends have been 7% throughout. Dividends were begun on the stock of the St. Paul, Minneapolis & Manitoba (the Great Northern's predecessor) in 1882, so the stockholders have enjoyed uninterrupted dividends for nearly forty years.

The Bureau of Valuation of the Interstate Commerce Commission has published a preliminary report of the physical valuation of the Great Northern Railway, which gives a figure of \$437,740,332 for cost of reproduction new, and \$376,742,378 for cost of reproduction less depreciation. The latter figure amounts to \$53,135 per mile. As already pointed out, the funded debt of the Great Northern, exclusive of its share of the new Joint bonds, is at the very low rate of \$22,890 per mile.

The New Joint 6½% Bonds

A careful consideration of the foregoing accounts of the financial strength of the Northern Pacific and the Great Northern Railway Companies and the great value of the stock of the Chicago, Burlington & Quincy, must convince the investor of the unequalled strength of the new Joint 15-year 6½% bonds which are being sold to refund the maturing 4s. These new bonds, of which there will be \$230,000,000 outstanding, will be secured by \$165,867,400 (out of a total of \$170,839,100 outstanding) stock of the Chicago, Burlington & Quincy, and in addition, \$33,000,000 Northern Pacific Railway Company Refunding & Improvement Mortgage 6% Bonds, Series B, due 2047, and \$33,000,000 Great Northern General Mortgage 7% Bonds, Series A, due 1936. Thus 72% of the collateral is stock and 28% bonds.

The interest requirements of the Joint 6½% bonds will be \$14,950,000 per annum. These charges are of course junior to the interest charges on the mortgage bonds of the two roads which are jointly liable. Heretofore, the regular 8% dividend on Chicago, Burlington & Quincy stock has sufficed

to meet the 4% interest on the maturing Joint bonds, so that the proprietary roads were not out of pocket as a result. Reference has already been made to the increase in stock of the Burlington by \$60,000,000, and should the 8% dividend be continued on the enlarged stock capitalization, as seems probable, the Great Northern and Northern Pacific would each receive in their treasuries as dividends \$6,634,696, and would be obligated to pay on the 6½% bonds \$7,475,000 per annum. Thus the net increase in fixed charges would amount to only \$830,304 for each obligor.

The following table has been prepared to show the earning power supporting the new Joint 6½% bonds. The income of the Burlington shown below, is 97.13% of the total net income after payment of all fixed charges, 97.13% being the amount of the stock of the Burlington jointly owned.

The income of the Great Northern and Northern Pacific available to meet the interest charges on the new bonds is the balance remaining after the payment of all other fixed charges of each road. These figures show that for the past five years, for which statistics are obtainable, the interest requirements on the new Joint 6½% have been earned a yearly average of 4.6 times.

	Income of C. B. & Q.	Income Nor. Pac.	Income Gr. North.	Total Income	Interest Charges Joint 6½%	Times Int. Charges Earned
1915.....	\$22,866,602	\$22,832,769	\$22,139,586	\$67,838,957	\$14,950,000	4.54
1916.....	22,138,255	20,125,366	20,083,270	62,346,891	14,950,000	4.17
1917.....	28,562,079	24,113,182	17,659,497	70,334,758	14,950,000	4.70
1918.....	32,047,777	25,725,906	27,600,614	85,374,297	14,950,000	5.71
1919.....	18,495,416	18,818,852	20,618,270	57,932,538	14,950,000	3.88
Average...	\$24,822,066	\$22,323,215	\$21,616,247	\$68,761,528	\$14,950,000	4.60

* Years ended June 30.

The maturing Joint 4s have been one of the most active of the listed bonds on the New York Stock Exchange, the volume of sales for that issue in 1919 being \$13,432,000, comparing with \$6,562,000 in Atchison General 4s and \$3,678,000 in U. S. Steel Sinking Fund 5s. The Joint 4s were listed on the Stock Exchange in 1901 and sold below 90 only twice; once in the depression of 1903 and again in the panic of 1907. The average selling price for the bonds during the past 20 years has been equivalent to a 5¼% basis.

The Conversion Privilege

One of the most attractive features of the new Joint bonds is the privilege to convert at any time prior to maturity into either Northern Pacific Series B Refunding & Improvement 6% Bonds, 2047, or the Great Northern General Mortgage 7s, 1936, up to the limit of \$115,000,000 of each issue.

There have been outstanding since 1914, \$20,000,000 of 4½% bonds, Series A under the Northern Pacific Refunding & Improvement Mortgage, which bonds have been listed on the Stock Exchange since 1918, and have ranged between 91 and 69. Since the first of January 1921, these 4½% bonds

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have sold as high as 81½, or a 5½% basis. The opportunity to convert the new Joint bonds into 6s at 96½, or a 6.20% basis, is therefore extremely attractive. The Northern Pacific Refunding bonds are secured by a first mortgage on 1,004 miles of road and cover in all 6,873 miles, principally subject to \$110,815,500 Prior Lien 4s, 1997, and \$60,000,000 General Lien 3s of 2047. The Northern Pacific 6s are a legal investment for savings banks and trustees in New York, Massachusetts, Connecticut and elsewhere.

The Great Northern General Mortgage 7s, 1936, are to be issued under a new mortgage dated January 1, 1921. They will be secured by a direct mortgage on 7,675 miles of road subject to prior liens outstanding at the very low rate of \$22,889 per mile of road owned. The First & Refunding Mortgage of 1961, which authorized the issuance of \$600,000,000 of bonds, is closed by the terms of the new General Mortgage. Under the First & Refunding Mortgage, \$35,668,000 of bonds are outstanding in the hands of the public, and \$36,332,000 are pledged under the new General Mortgage; \$24,200,000 being pledged subject to a lien of \$17,910,000 in favor of the United States Government to secure a loan made in 1920. The opportunity to convert the Joint bonds par for par into Great Northern General Mortgage 7s enables the investor to secure a high grade bond of this great railway system on a 7.38% basis. This is an exceptionally attractive opportunity in view of the recent quotations for other high grade bonds, viz.: New York Central and Delaware & Hudson ten-year 7s on a 6½% basis, and Chicago & Northwestern and Pennsylvania 15-year 6½s on a 6½% basis.

The Outlook for the Railroads

The real measure of the earning power of the three railroads under discussion and of all other American railroads is not found in their recent statements, which have been unsatisfactory. The conditions producing these earnings are, we believe, temporary, and we are optimistic as to the future. By the terms of the Transportation Act of 1920, the Interstate Commerce Commission was instructed to establish a rate structure which would yield 5½% on the value of railroad property, with a discretionary ½% to be used for additions and betterments. In its decision, the Interstate Commerce Commission placed a preliminary valuation on the property of the western carriers of \$8,100,000,000, and the rate structure was designed to yield net earnings of \$486,000,000. The actual earnings made by the western carriers in the so-called test period, that is, the three years ended June 30, 1917, were \$401,215,984. Granted reasonable operating costs and a normal volume of traffic, these three great western roads should have no difficulty in producing sufficient earnings to maintain in the future the high credit standing that their securities have had for many years past.

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